



## Utilities/Power

### Water Utilities: For growth and safety; Initiating coverage of AWK, AWR, CWT, SJW, and WTRG

#### Summary:

We are initiating coverage of water utilities with a bullish outlook, and **AWK** and **AWR** as our top picks, while we're Neutral on **CWT**, **SJW**, and **WTRG**.

To us, there is no better utility than a water utility:

- The water/wastewater industry remains highly fragmented with ~90% of the US population getting water/wastewater services from municipally-owned systems.
- Water/wastewater systems, especially those owned by municipalities, are heavily under-invested and often non-compliant with EPA regulations. While munis resist water/wastewater M&A, growing budget pressures coupled with fair value laws should facilitate privatizations.
- Outside of CA/HI, water/wastewater bills remain low. The current work-from-home arrangements inflate higher-margin residential water volumes, and we'd expect at least some of this volume uptick to persist beyond 2020, benefiting AWK and WTRG in particular.
- Water/wastewater capex is non-cyclical and highly fragmented.
- Water utilities have high ESG/sustainability ratings. Those translate into rich valuations and a very low cost of financing.

The debate about the right multiple for water vs. electric utilities continues. An average water utility under our coverage grows EPS/DPS at a ~9%/~8% rate or ~300 bps/~300 bps faster than an average regulated electric utility. However, the water EPS growth rates are inflated by recent M&A deals and/or non-water earnings. Based on our 2022 EPS estimates, water utilities under our coverage trade at a ~45% P/E premium to an average regulated electric utility (24.6x vs. 16.9x respectively) which is in line with the historical average. The average 2019 EV/Rate base multiple of 1.78x also seems average.

#### Highlights

##### Water utilities: Trading multiples

	Rating	Market Cap (\$B)	2019 EV/Rate Base	2022 P/E	2019-2022 EPS CAGR	2019-2022 DPS CAGR
AWK	Buy	22.2	1.74x	26.2x	8.3%	10.0%
AWR	Buy	2.9	1.77x	29.2x	4.9%	7.6%
CWT	Neutral	2.2	1.76x	23.9x	11.5%	7.4%
SJW	Neutral	1.6	1.68x	21.0x	14.0%	6.9%
WTRG	Neutral	10.1	1.94x	22.7x	6.3%	7.0%
<b>Average water</b>			<b>1.78x</b>	<b>24.6x</b>	<b>9.0%</b>	<b>7.8%</b>

Source: FactSet, Seaport Global Securities

##### Water utilities: EPS/DPS CAGRs

	2019-2022 EPS CAGR	2019-2022 DPS CAGR
AWK	8.3%	10.0%
AWR	4.9%	7.6%
CWT	11.5%	7.4%
SJW	14.0%	6.9%
WTRG	6.3%	7.0%
<b>Average</b>	<b>9.0%</b>	<b>7.8%</b>

Source: Seaport Global Securities

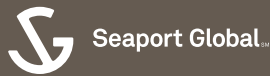
**AWK (Buy):** AWK's scale and strong operational execution position it well to benefit from ongoing privatization of municipal water/wastewater systems. We acknowledge AWK's 60%+ debt/cap and pending/upcoming rate cases in three of its largest jurisdictions happening during the COVID-19 pandemic. Yet, the strain on municipal budgets on the back of this pandemic could further accelerate muni water deals, with AWK best positioned to consolidate the industry.

**AWR (Buy):** The company keeps surprising to the upside on its regulated water/electric earnings thanks to strong regulatory and operational execution in CA. Though AWR trades at the highest PE multiple among water names under our coverage, it's largely a function of its military water/wastewater contracts, we believe. When we adjust AWR's EV for those contracts, the stock trades in line with peers on 2019 EV/Rate base.

**CWT (Neutral):** With its rate base/customer more than a third lower than that of its public peers, CWT offers unmatched long-term EPS growth prospects. Yet, a pending decision by CA regulators in CWT's general rate case could meaningfully increase the volatility in its earnings by removing revenue decoupling and/or balancing accounts for pension/medical expenses. The latter seems likely to us.

**SJW (Neutral):** The recent cancelation of SJW's temporary revenue decoupling mechanism in CA and a lack of a balancing account for purchase water costs in the state have more severe earnings implications than we once expected. Through the merger with CTWS, SJW reduced its concentration on CA, but the volatility in SJW's earnings is still pretty severe. The stock trades at a large 15% P/E discount to an average water utility on our 2022 EPS though just a 5% discount based on the 2019 EV/Rate base multiples. The volatility in SJW's earnings should persist through at least 2021 because SJW's San Jose Water plans to ask for a purchased water tracker in its next general rate case in CA covering 2022-2024.

**WTRG (Neutral):** To us, WTRG's recent purchase of a gas utility (Peoples Gas) muddled the original water growth story in exchange for a ~150+ bps pick-up in WTRG's EPS CAGR. Management should pursue a catch-up repair tax deduction for Peoples Gas in PA, but we'd expect most of the earnings benefit to be shared with ratepayers. Given its higher operating risk profile, WTRG's gas earnings are unlikely to ever trade at a water P/E. Given the earnings mix, WTRG seems therefore fairly valued to us.



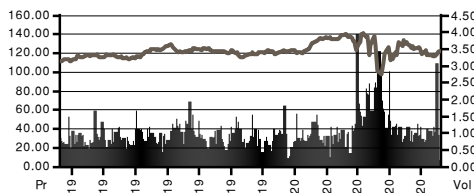
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**Rating:** Buy  
**Price Target:** \$130.00

**Price Target Metrics:**  
2022 SOTP valuation implying 28.4x 2022 EPS

**Current Price:** \$120.17  
**Float:** 180.5MM  
**Diluted Shares:** 181.0MM  
**Short Interest:** 2.0MM  
**Average Daily Volume:** 1,097k  
**52 Week Range:** \$92.00 - \$141.70  
**Market Cap:** \$21,751MM  
**Cash and Investments:** \$1MM  
**Debt:** \$10,315MM  
**Enterprise Value:** \$32,065MM

#### PRICE & VOLUME CHART



#### ESTIMATES \$ (MMs except multiples & EPS)

	2019	2020	2021	2022
<b>EPS (Adjusted)</b>				
FY	\$3.61A	\$3.84E	\$4.23E	\$4.59E
P/E	33.3x	31.3x	28.4x	26.2x
<b>Dividends Per Share</b>				
FY	\$1.955A	\$2.150E	\$2.365E	\$2.600E
Dividend Yield	1.6%	1.8%	2.0%	2.2%

## American Water Works Company, Inc.

(NYSE: AWK)

### Best-in-class water growth story

#### Summary:

We are initiating coverage of AWK with a Buy rating and a \$130 price target based on our 2022 SOTP valuation implying 28.4x our 2022 EPS. We see the rich valuation as warranted by AWK's multi-decade investment needs, its low risk profile and growth in ESG-related investing. AWK's above-average 8.3%/10% EPS/DPS CAGR between 2019-2022 should be achievable largely regardless of future economic cycles, driven by organic capex and acquisitions of municipal water systems (~7% EPS growth), with contracted services adding an additional ~1-1.5% to the growth. Assuming no federal infrastructure bill, the current COVID-19 pandemic could, over time, boost muni water/wastewater M&A for large water operators such as AWK. We admit that it's not ideal, however, that AWK will be asking for meaningfully higher rates in three of its largest regulatory jurisdictions (NJ, PA and MO) during the COVID-19 pandemic, or that AWK's net debt/cap should exceed 60% through 2021/2022.

#### Highlights

**Regulated utilities (~88% of 2022 EPS):** AWK's 7-8% rate base CAGR between 2019 and 2024 is supported by organic water main replacement capex and acquisitions of municipal water/wastewater systems. While AWK's existing systems offer decades of growth, the customer bill affordability is the key limiting factor for the organic growth. AWK's muni M&A is focused on rural systems with 30,000-60,000 existing customer accounts in states which adopted fair value legislation or similar laws. Assuming no federal infrastructure bill, the muni M&A in the water sector could further accelerate benefiting large water utilities such as AWK in particular, we believe.

**Contract-based operations (~12% of 2022 EPS):** AWK provides water/wastewater services to 16 military, with pending solicitations for five more contracts, three of which to be awarded still this year. Given the 50-year duration, inflation indexation, premium returns, and the exclusive nature of these contracts we see them as even more valuable than the regulated water business. AWK won more than 50% of all new military water/wastewater service contracts offered to private contractors over the last couple of years, with AWR as the only real competitor in this field. AWK's Homeowner Services business offers warranties mainly for wastewater sewer lines not covered by homeowner's insurance. The business EPS should grow at a ~9% CAGR between 2019 and 2022. We recognize a higher risk profile of this business, reflected in a lower P/E multiple in our 2022 SOTP, but also its strong cash flow generation.

**2020 earnings:** Management reiterated its 2020 EPS guidance despite the COVID-19 pandemic as higher residential water consumption (~70% of total regulated sales volumes) should more than offset lower C&I volumes, and any meaningful COVID-related expenses, if material, should be deferred. Admittedly, AWK's 2020 earnings guidance always seemed conservative to us though we recognize that it's a particularly busy year on the regulatory front with AWK seeking large revenue increases (US \$224MM annualized) in four states, including NJ and PA, AWK's largest jurisdictions, with a likely MO rate case coming later this year.

#### Company Description:

AWK is the largest publicly-traded regulated water and wastewater utility in the US with operations in 16 states, primarily in the Northeast and the Midwest, serving 3.4 million customer accounts. AWK also engages in unregulated contract-based water/wastewater services for military bases (16 bases) and provides water/wastewater line warranty services (homeowner services) to ~1.5 million residential accounts

**AWK: EPS breakdown by segment (\$)**

<b>AWK</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	<b>'19-'22 CAGR</b>
Regulated utilities	3.32	3.60	3.80	4.16	4.50	7.7%
Unregulated ops	0.33	0.45	0.48	0.51	0.56	7.6%
Parent	-0.35	-0.44	-0.44	-0.44	-0.47	2.5%
<b>Total EPS</b>	<b>3.30</b>	<b>3.61</b>	<b>3.84</b>	<b>4.23</b>	<b>4.59</b>	<b>8.3%</b>
<b>DPS</b>	<b>1.78</b>	<b>1.96</b>	<b>2.15</b>	<b>2.37</b>	<b>2.60</b>	<b>10.0%</b>
Dividend payout	54%	54%	56%	56%	57%	

Source: Company data for 2018-2019; Seaport Global Securities

**AWK - 2022 SOTP valuation**

<b>AWK - 2022 SOTP</b>	<b>EPS</b>	<b>Multiple</b>	<b>Value per share</b>
Regulated utilities less parent	4.03	27.9x	112.32
Military contracts	0.19	41.9x	7.95
Homeowner services	0.37	25.0x	9.25
<b>Total per share</b>			<b>129.52</b>

Source: Seaport Global Securities

## Risks

**Allowed ROEs for AWK's regulated utilities could fall due to lower market interest rates:** Equity returns/ROE of regulated electric/gas/water utilities are indirectly linked to the 10-year Treasury yield. The average allowed ROE of a regulated utility in the US dropped just 25 bps since 2008 despite a 152 bps drop in the average 10-year T yield over this period. However, state utility regulators could sharply reduce allowed ROEs of regulated utilities going forward which currently average 9.75% average. The allowed ROE together with an equity ratio are the key drivers of regulated utility earnings.

**Lower sales volumes could weigh on AWK's realized ROEs and thus earnings:** A utility can see a meaningful deficiency between its realized and allowed ROE depending on the level of sales volumes and operating expenses. While the latter can be controlled, sharp reductions in sales volumes due to energy efficiency (residential and commercial sales) or closure of industrial facilities. The latter is particularly pronounced during the COVID pandemic. The sharply lower C&I sales volumes could weigh on utility earnings beyond 2020. While rate cases could true up sales volume assumptions, utilities could delay rate filings because their ROE could be reduced during those proceedings on the back of sharply lower interest rates.

**Rate case outcomes are hard to predict:** While regulated utilities are allowed to recover prudently incurred costs, its up to state utility regulators to determine which costs are in fact recoverable and the return on regulated assets. Some rate case requesting higher revenues may end with a reduction in authorized rates thus revenues and thus earnings. AWK has a particularly busy regulatory calendar in 2020, with rate cases in three of its largest jurisdictions – NJ, PA and MO.

**Potentially higher equity needs due to weakening operating cash flows and underfunded pension funds:** Lower customer collections (due to lower sales or non-payment) coupled with growing federal cash taxes and underperforming pension funds should be weighing on operating cash flows of regulated utilities especially during/following the COVID-19 pandemic. That in turn could require some deleveraging of balance sheets of regulated utilities thus more equity. AWK already announced ~\$500m in new equity as soon as 2022, but the issuances could be enlarged and accelerated to protect AWK's credit ratings.

AWK	2018A	2019A	2020E	2021E	2022E
Sales	3,440	3,610	3,775	4,008	4,220
Operating expenses	1,773	1,824	1,871	1,919	1,969
EBITDA	1,667	1,786	1,904	2,089	2,251
Depreciation	545	582	626	670	714
EBIT	1,122	1,204	1,278	1,419	1,538
Net interest expense	350	382	402	442	460
Ordinary Profit Before Tax	809	872	926	1,027	1,127
Income tax	216	218	232	257	282
Net profit	593	654	695	770	845
S/O (m)	180	181	181	182	184
<b>Diluted EPS</b>	<b>3.30</b>	<b>3.61</b>	<b>3.84</b>	<b>4.23</b>	<b>4.59</b>
<b>DPS</b>	<b>1.78</b>	<b>1.96</b>	<b>2.15</b>	<b>2.37</b>	<b>2.60</b>
Cash	158	90	45	45	45
Financial and Operating Receivables	301	294	311	330	348
Inventory	41	44	44	45	46
Other short-term assets	281	857	292	292	292
Goodwill	1,575	1,501	1,501	1,501	1,501
Other long term assets	1,458	1,664	1,664	1,664	1,664
Property, plant, and equipment	17,409	18,232	19,475	20,675	21,832
<b>Total assets</b>	<b>21,223</b>	<b>22,682</b>	<b>23,332</b>	<b>24,552</b>	<b>25,727</b>
Financial liabilities	1,035	814	936	936	936
Operating liabilities	175	203	194	199	204
Other liabilities	884	1,028	851	851	851
Deferred credits and other regulatory liabilities	5,689	5,872	6,053	6,253	6,396
Long-term debt	7,576	8,639	9,472	9,896	10,408
Shareholders' equity	5,864	6,126	5,827	6,418	6,933
<b>Total liabilities and equity</b>	<b>21,223</b>	<b>22,682</b>	<b>23,332</b>	<b>24,552</b>	<b>25,727</b>
Net income	565	654	695	770	845
D&A, goodwill amortisation	545	582	626	670	714
Other non cash elements	308	214	181	200	220
Funds from operations	1,418	1,450	1,501	1,640	1,779
Decrease (increase) in non-cash working capital	-32	-67	-26	-15	-91
<b>CFO</b>	<b>1,386</b>	<b>1,383</b>	<b>1,475</b>	<b>1,625</b>	<b>1,688</b>
Net investments in fixed assets	-1,949	-1,841	-1,865	-1,865	-1,865
Net investments in financial assets	-87	-104	-104	-104	-104
<b>Free cash flow before dividends</b>	<b>-650</b>	<b>-562</b>	<b>-494</b>	<b>-344</b>	<b>-281</b>
Dividends paid (group + minorities)	-319	-354	-389	-431	-479
Free cash flow after dividends	-969	-916	-883	-775	-760
Increase or (repayment) of capital and subsidiaries	892	857	883	474	562
Increase or (repayment) of financial debt	138	-36	-45	301	198
Adjustment for minorities / miscellaneous	14	27	0	0	0
Increase in cash	75	-68	-45	0	0



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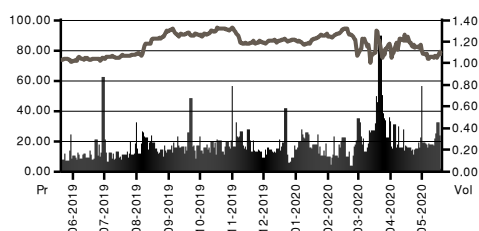
**Rating:** Buy  
**Price Target:** \$84.00

**Price Target Metrics:**

2022 SOTP valuation which implies 32.6x '22 EPS

<b>Current Price:</b>	<b>\$75.62</b>
Float:	36.4MM
Diluted Shares:	37.0MM
Short Interest:	1.0MM
Average Daily Volume:	286k
52 Week Range:	\$65.11 - \$96.64
<b>Market Cap:</b>	<b>\$2,796MM</b>
Cash and Investments:	\$6MM
Debt:	\$339MM
Enterprise Value:	\$3,129MM

**PRICE & VOLUME CHART**



**ESTIMATES \$ (MMs except multiples & EPS)**

	2019	2020	2021	2022
<b>EPS (Diluted)</b>				
FY	\$2.24A	\$2.31E	\$2.45E	\$2.58E
P/E	33.8x	32.8x	30.9x	29.3x
<b>Dividends Per Share</b>				
FY	\$1.160A	\$1.263E	\$1.351E	\$1.446E
Dividend Yield	1.5%	1.7%	1.8%	1.9%

## American States Water Company

(NYSE: AWR)

### Pricey water utility, but with best-in-class execution

#### Summary:

We are initiating coverage of AWR with a Buy rating and an US\$84 price target based on our 2022 SOTP valuation which implies 32.6x our 2022 EPS. Trading at 29.2x our '22 EPS, AWR is the most expensive utility under our coverage despite a peer-average EPS/DPS annual growth of ~4.9%/~7.6%. Yet, this is the only CA-based water utility which has always earned at least its allowed ROE and the Street (us included) has historically underestimated AWR's earnings power. While losses in a pension account incurred in March pose some EPS headwind for 2020, we still expect the company to beat its 2020 consensus EPS through higher regulated electric and contract-based earnings. A new general rate case and a cost of capital proceeding will determine AWR's 2022 EPS on the water side, but we still expect our/consensus estimates to turn out low.

#### Highlights

**Regulated water/wastewater utilities (~70% of 2022 EPS):** Golden States Water Company (GSWC) has been uniquely successful at earning its allowed ROE and getting regulatory approvals for higher water capex through general rate cases and separate advisory letters. The next general rate case (to be filed in July) and the cost of capital proceeding (to be filed in May 2021) should determine GSWC's earnings power for 2022-2024, and we are hoping for meaningful upside to our 2022 EPS due to higher capex though the allowed ROE (to be determined in a separate proceeding) remains uncertain.

**Military contracts/ASUS (~21% of 2022 EPS):** Through its unregulated American States Utility Services (ASUS) business, AWR provides water/wastewater services to 11 military bases under 50-year inflation-indexed contracts. The contracts offer periodic openers to account for incremental scope of work thus higher expenses or incremental infrastructure upgrades. Given the duration, premium returns, and the exclusive nature of these contracts we see them as even more valuable than the regulated water business. Hence, in our SOTP, we value the contracts at a 50% P/E premium to water utilities. We see at least three pending RFPs for new water/wastewater contracts for military bases, and while the contract awards may get delayed due to COVID-19, we'd expect at least one of these contracts to be awarded to AWR.

**2020 earnings:** Thanks to revenue decoupling on both the water and electric side, balancing accounts for both purchased water and power costs, and a catastrophic event memorandum account tracking COVID-related expenses, AWR should not see much of a COVID-19 impact on its regulated earnings if not for losses in one of its pension account, an US\$0.08 YoY EPS hit in 1Q20. However, it has yet again become apparent to us that we were underestimating AWR's earnings power on the electric/water side. Management expects to fully execute its water/electric capex plan during 2020. The military contracts division saw some cost overruns during 1Q20, but that's just a timing issue.

#### Company Description:

AWR is the parent of Golden States Water Co. (GSWC), a regulated water (261,000 water connections in 37 systems) and electric utility (24,400 electric connections in one system) in CA, and American States Utility Services (ASUS), which engages in contract-based water and wastewater services primarily for military bases, currently 11 bases.



**AWR: EPS breakdown by segment (\$)**

<b>AWR</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	<b>2019-2022 CAGR</b>
Regulated water	1.62	1.64	1.73	1.82	4.1%
Regulated electric	0.15	0.18	0.20	0.21	11.9%
Military contracts/ASUS	0.47	0.49	0.52	0.55	5.4%
<b>Total EPS</b>	<b>2.24</b>	<b>2.31</b>	<b>2.45</b>	<b>2.58</b>	<b>4.9%</b>
<b>DPS</b>	<b>1.16</b>	<b>1.26</b>	<b>1.35</b>	<b>1.45</b>	<b>7.6%</b>
Dividend payout	52%	55%	55%	56%	

Source: Company data for 2019; Seaport Global Securities

**AWR: 2020 Sum-Of-The-Parts valuation (\$)**

<b>AWR - SOTP</b>	<b>Metric</b>	<b>Multiple</b>	<b>Price Anchor</b>	<b>PE</b>	<b>PE premium</b>
2022 Regulated Water EPS	1.82	30.7x	\$55.91	27.9x	10%
2022 Regulated Electric EPS	0.21	20.7x	\$4.35	18.0x	15%
2022 ASUS EPS	0.55	43.2x	\$23.78	27.9x	55%
<b>Total equity value/sh</b>			<b>\$84.04</b>		

Source: Seaport Global Securities

## Risks

**Allowed ROEs for AWR's regulated utilities could fall due to lower market interest rates:** Equity returns/ROE of regulated electric/gas/water utilities are indirectly linked to the 10-year Treasury yield. The average allowed ROE of a regulated utility in the US dropped just 25 bps since 2008 despite a 152 bps drop in the average 10-year T yield over this period. However, state utility regulators could sharply reduce allowed ROEs of regulated utilities going forward which currently average 9.75% average. The allowed ROE together with an equity ratio are the key drivers of regulated utility earnings. AWR's allowed ROE for its water utility for 2022-2024 should be set by late 2021 in a cost of capital proceeding.

**Rate case outcomes are hard to predict:** While regulated utilities are allowed to recover prudently incurred costs, it's up to state utility regulators to determine which costs are in fact recoverable and the return on regulated assets. Some rate case requesting higher revenues may end with a reduction in authorized rates thus revenues and thus earnings. AWR should be filing a new water rate case by July 2020 with new rates in effect in January 2021.

**Returns in pension accounts impact AWR's earnings in between rate cases in CA:** AWR has no balancing account tracking changes in returns in its pension accounts. Those changes can be trued up/reflected in AWR's rates during rate cases, but those take place every three years.

**Military contracts are highly competitive:** Through its unregulated ASUS subsidiary, AWR provides water and wastewater services to 11 military bases. The company awaits awards of up to three more of these contracts in 2020. We assume that AWR secures at least one new military contract per year in 2020-2022 though AWK, AWR's largest competitor, has been winning most of the contract awards as of late.

<b>AWR</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
Total Revenues	437	474	490	504	525
Total Operating Expenses	336	347	360	369	382
Operating income	101	127	130	136	144
EBT	82	107	109	115	122
Income tax expense	18	25	24	25	27
Net income	\$ 64	\$ 83	\$ 85	\$ 90	\$ 95
S/O	37	37	37	37	37
<b>Diluted EPS</b>	<b>\$1.72</b>	<b>\$2.24</b>	<b>\$2.31</b>	<b>\$2.45</b>	<b>\$2.58</b>
<b>DPS</b>	<b>\$1.06</b>	<b>\$1.16</b>	<b>\$1.26</b>	<b>\$1.35</b>	<b>\$1.45</b>
Net income	64	83	85	90	95
Adjustments to reconcile non-cash charges	40	42	46	48	51
Changes in assets and liabilities	33	(8)	(12)	(12)	(12)
CFO	137	117	119	126	134
Capital expenditures	(127)	(152)	(125)	(135)	(135)
Other	(1)	(1)	-	-	-
CFI	(128)	(153)	(125)	(135)	(135)
Issuance/repurchase of common stock	1	1	1	1	1
Long-term debt issued/repaid	(0)	(40)	30	45	45
Short-term debt issued/repaid	37	110	20	15	15
Dividends paid	(39)	(43)	(47)	(50)	(53)
Other	0	4	4	4	4
CFF	(2)	31	7	14	11
Net change in cash and cash equivalents	2	(6)	2	5	10
Cash and cash equivalents, end of period	7	1	3	8	18
Current assets	\$ 131	\$ 122	\$ 125	\$ 132	\$ 144
PP&E	1,323	1,447	1,526	1,621	1,715
Regulatory and other assets	47	72	72	72	72
Total assets	1,501	1,641	1,723	1,825	1,931
Current liabilities	147	116	157	157	157
Long-term debt	281	281	311	356	401
Other liabilities (including construction)	516	643	643	643	643
Total liabilities	943	1,040	1,111	1,156	1,201
Total Shareholders' Equity	558	601	612	668	730
Liabilities and Shareholders' Equity	\$ 1,501	\$ 1,641	\$ 1,723	\$ 1,825	\$ 1,931





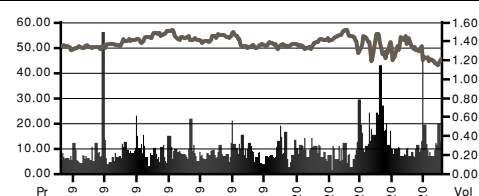
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**Rating:** Neutral  
**Price Target:** N/A

**Price Target Metrics:**  
N/A

<b>Current Price:</b>	<b>\$43.58</b>
Float:	48.3MM
Diluted Shares:	48.6MM
Short Interest:	1.0MM
Average Daily Volume:	335k
52 Week Range:	\$39.74 - \$57.48
<b>Market Cap:</b>	<b>\$2,117MM</b>
Cash and Investments:	\$141MM
Debt:	\$1,143MM
Enterprise Value:	\$3,120MM

**PRICE & VOLUME CHART**



**ESTIMATES \$ (MMs except multiples & EPS)**

	2019	2020	2021	2022
<b>EPS (Diluted)</b>				
FY	\$1.31A	\$1.40E	\$1.70E	\$1.82E
P/E	33.2x	31.1x	25.7x	23.9x
<b>Dividends Per Share</b>				
FY	\$0.790A	\$0.850E	\$0.909E	\$0.978E
Dividend Yield	1.8%	2.0%	2.1%	2.2%

## California Water Services Group

(NYSE: CWT)

### Potential earnings volatility overshadows strong rate base growth

#### Summary:

Thanks to its highly underinvested water systems, CWT offers the fastest earnings growth in regulated water earnings among publicly-traded companies – we project an 11.5% EPS CAGR between 2019 and 2022. However, depending on the outcome of a pending rate case in CA and given conservatism of CWT's management, we could see meaningful volatility in CWT's earnings driven by changes in sales volumes as well higher operating expenses related to pensions, medical insurance and COVID-19. Therefore, we are initiating coverage with a Neutral rating as we await the outcome of CWT's general rate case in CA by July.

#### Highlights

**Regulated water (98% of 2022 EPS):** Based on the 2019 rate base per customer connection, CWT's water systems are more than a third less invested than those of its public water peers, even despite sharp capex increases in the last two of CWT's rate cases in CA. CWT's earnings largely followed higher capex and we now project an 11% EPS CAGR between 2019 and 2022. However, CWT awaits a proposed decision in its latest general rate case in CA, and while the utility settled with the consumer advocate on key issues back in October 2019, the revenue decoupling and recovery of pension/medical costs through balancing accounts remain disputed. We don't expect CWT to lose its revenue decoupling though balancing accounts for pension/medical costs might not get renewed, and that could add some volatility in CWT's earnings.

**2020 earnings:** CWT is tracking COVID-related expenses in a catastrophic memorandum account, but unlike other CA utilities, it plans to expense the costs until they are recovered in the next rate case. Also, depending on the outcome of the pending general rate case, CWT could be exposed to higher pension and medical costs given a potential removal of balancing accounts for these costs. It helps that CWT never provides earnings guidance, but we see downside to our/consensus estimates for 2020-2022 depending on the outcome of the CA rate case.

#### CWT: EPS/DPS projections

CWT	2018A	2019A	2020E	2021E	2022E	2019-2022 CAGR
Total EPS	1.36	1.31	1.40	1.70	1.82	11.5%
DPS	0.75	0.79	0.85	0.91	0.98	7.4%
Dividend payout	55%	60%	61%	54%	54%	

Source: Company data for 2018-2019; Seaport Global Securities

#### Company Description:

CWT operates regulated water and wastewater utilities in CA, WA, HI and NM, with 490,000 connections in CA (90%), 36,000 connections in WA (recently doubled through an acquisition), 5,000 in HI, and 8,300 connections in NM.

## Risks

**Allowed ROEs for CWT's regulated water utilities could fall due to lower market interest rates:**

Equity returns/ROE of regulated electric/gas/water utilities are indirectly linked to the 10-year Treasury yield. The average allowed ROE of a regulated utility in the US dropped just 25 bps since 2008 despite a 152 bps drop in the average 10-year T yield over this period. However, state utility regulators could sharply reduce allowed ROEs of regulated utilities going forward which currently average 9.75% average. The allowed ROE together with an equity ratio are the key drivers of regulated utility earnings. CWT's allowed ROE for its water utility for 2022-2024 should be set by late 2021 in a cost of capital proceeding.

**Rate case outcomes are hard to predict:** While regulated utilities are allowed to recover prudently incurred costs, it's up to state utility regulators to determine which costs are in fact recoverable and the return on regulated assets. Some rate case requesting higher revenues may end with a reduction in authorized rates thus revenues and thus earnings. CWT awaits a proposed decision in its 2018 general rate case in CA with rates retroactive to January 1, 2021. Though the utility reached a partial settlement with the consumer advocate late in 2019, outstanding issues involve the continuation of the revenue decoupling and balancing accounts for pension and medical expenses. Without those, CWT could see a meaningful spike in its earnings volatility.

<b>CWT</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
EBIT	132	117	126	149	160
EBITDA	218	209	225	255	274
Net interest expense	38	41	44	45	47
Net income	66	63	69	87	96
<b>EPS</b>	<b>\$1.36</b>	<b>\$1.31</b>	<b>\$1.40</b>	<b>\$1.70</b>	<b>\$1.82</b>
<b>DPS</b>	<b>\$0.75</b>	<b>\$0.79</b>	<b>\$0.85</b>	<b>\$0.91</b>	<b>\$0.98</b>
<b>CFO</b>	<b>\$ 179</b>	<b>\$ 169</b>	<b>\$ 189</b>	<b>\$ 214</b>	<b>\$ 231</b>
Utility plant expenditures	(272)	(274)	(275)	(285)	(285)
Other	(1)	(2)	(2)	(2)	(2)
<b>CFI</b>	<b>(273)</b>	<b>(276)</b>	<b>(277)</b>	<b>(287)</b>	<b>(287)</b>
Issuance of common stock	(2)	18	96	80	86
Issuance of debt	73	103	28	32	32
Dividends	(36)	(38)	(41)	(44)	(47)
Other	11	20	20	20	20
<b>CFF</b>	<b>47</b>	<b>103</b>	<b>103</b>	<b>88</b>	<b>91</b>
Change in cash and cash equivalents	(48)	(4)	14	15	35
Net utility plant	2,233	2,406	2,583	2,761	2,932
Cash and cash equivalents	47	43	63	78	112
Other current assets	142	142	142	142	142
Total current assets	189	184	204	219	254
Regulatory assets	354	433	433	433	433
Goodwill	3	3	3	3	3
Other assets	60	85	85	85	85
<b>Total assets</b>	<b>\$ 2,838</b>	<b>\$ 3,111</b>	<b>\$ 3,308</b>	<b>\$ 3,502</b>	<b>\$ 3,707</b>
Total common stockholders' equity	\$ 730	\$ 780	\$ 808	\$ 851	\$ 900
Long-term debt, less current maturities	710	787	814	847	879
<b>Total capitalization</b>	<b>1,440</b>	<b>1,567</b>	<b>1,622</b>	<b>1,698</b>	<b>1,778</b>
Total current liabilities	321	359	479	578	682
Deferred income taxes	213	223	223	223	223
Pension and postretirement benefits of	194	259	259	259	259
Other long-term liabilities	257	270	270	270	270
Advances for construction	186	191	191	191	191
Contributions in aid of construction	225	242	262	282	302
<b>Total capitalization and liabilities</b>	<b>\$ 2,838</b>	<b>\$ 3,111</b>	<b>\$ 3,308</b>	<b>\$ 3,502</b>	<b>\$ 3,707</b>



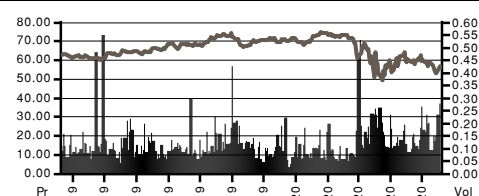
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**Rating:** Neutral  
**Price Target:** N/A

**Price Target Metrics:**  
N/A

**Current Price:** \$55.44  
**Float:** 26.0MM  
**Diluted Shares:** 28.7MM  
**Short Interest:** 0.3MM  
**Average Daily Volume:** 160k  
**52 Week Range:** \$45.60 - \$74.99  
**Market Cap:** \$1,590MM  
**Cash and Investments:** \$28MM  
**Debt:** \$1,471MM  
**Enterprise Value:** \$3,032MM

**PRICE & VOLUME CHART**



**ESTIMATES \$ (MMs except multiples & EPS)**

	2019	2020	2021	2022
<b>EPS (Diluted)</b>				
FY	\$1.78A	\$1.97E	\$2.42E	\$2.64E
P/E	31.1x	28.2x	22.9x	21.0x
<b>Dividends Per Share</b>				
FY	\$1.200A	\$1.280E	\$1.370E	\$1.465E
Dividend Yield	2.2%	2.3%	2.5%	2.6%

## SJW Group

(NYSE: SJW)

### Earnings volatility too high to handle

#### Summary:

We are initiating coverage of SJW with a Neutral rating as volatility in SJW's CA earnings (~60% of our 2022 EPS) meaningfully limits the investment appeal of this pure-play regulated water utility. While last year's merger with Connecticut Water Service reduced SJW's exposure to CA and San Jose Water is likely to request a purchased water cost tracker in its next general rate case, we are at least two years away from clarity on this issue. Additionally, SJW's earnings for 2021/2022 should be highly impacted by its upcoming rate cases in CT and CA with some risks of regulatory clawbacks of any merger-related savings, especially in CA.

#### Highlights

**Regulated water/wastewater utilities (95% of 2022 EPS):** SJW operates in states with relatively constructive regulatory regimes for water utilities. CT and ME, the jurisdictions of the recently acquired Connecticut Water Service, offer revenue decoupling mechanisms and capex riders thus ensuring that the utilities fully earn their allowed ROEs. In CA, the state offers three-year visibility into capex and separates rate cases from the ROE/equity ratio proceedings, but consumer advocates have been pushing back against revenue decoupling, and San Jose Water has recently lost its temporary decoupling retroactive to 2018. Worse yet, the utility does not currently have a purchased water tracker which should cost SJW even US\$0.30 in EPS this year. In TX, SJW sees meaningful growth opportunities supported by a recently adopted fair value legislation, though admittedly starting from a very low customer count. The state has recently adopted a capex recovery rider (DSIC).

**2020 earnings:** Management issued its first ever earnings guidance in February, but had to lower it by 13% just two months later due to sharply higher purchased water costs due to the lower surface water availability of just ~1.1B vs. 3.5B gallons typically. Additionally, while SJW can track (and eventually recover) COVID-related expenses (including bad debts) in CA through a catastrophic event memorandum account, the utility could see lower capex deployed in the state during 2020, with a catch up in 2021. While SJW no longer has even a temporary revenue decoupling in CA, the COVID pandemic should result in a net increase in water sales volumes as SJW's customer base is predominantly residential (60% of revenues) and apartment buildings dominate among commercial accounts. Those higher volumes could offer some earnings benefit in 2020.

#### SJW: EPS/DPS growth prospects

SJW	2019A	2020E	2021E	2022E	2019-2022 CAGR
Total EPS	1.78	1.97	2.42	2.64	14.0%
DPS	1.20	1.28	1.37	1.47	6.9%
Dividend payout	67%	65%	57%	55%	

Source: Company data for 2019; Seaport Global Securities

#### Company Description:

SJW Group is a regulated water and wastewater utility serving ~390,000 accounts across CA, CT, TX and ME. SJW merged with Connecticut Water Service in October 2019.

## Risks

**Allowed ROEs for SJW's regulated water utilities could fall due to lower market interest rates:** Equity returns/ROE of regulated electric/gas/water utilities are indirectly linked to the 10-year Treasury yield. The average allowed ROE of a regulated utility in the US dropped just 25 bps since 2008 despite a 152 bps drop in the average 10-year T yield over this period. However, state utility regulators could sharply reduce allowed ROEs of regulated utilities going forward which currently average 9.75% average. The allowed ROE together with an equity ratio are the key drivers of regulated utility earnings. SJW's allowed ROE for its CA water utility for 2022-2024 should be set by late 2021 in a cost of capital proceeding.

**Rate case outcomes are hard to predict:** While regulated utilities are allowed to recover prudently incurred costs, it's up to state utility regulators to determine which costs are in fact recoverable and the return on regulated assets. Some rate case requesting higher revenues may end with a reduction in authorized rates thus revenues and thus earnings. SJW should file a rate case for its new CT business in 2021. Also, the CA utility of SJW should go through a general rate case in the state in 2021 and state regulators could attempt to claw-back some synergies related to the recent merger with CTWS.

**SJW's CA earnings are highly volatile:** Now that SJW no longer has even a temporary decoupling mechanism in CA, its CA earnings change along with changes in volumes and changes in purchased water costs. SJW plans to ask for a purchased water cost balancing account in the next rate case in CA, but that means that 2021 could be another weak earnings year before the regulatory fix arrives for 2022, if at all.

<b>SJW</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
EBITDA	157	210	231	242
Net income	51	56	69	76
<b>EPS diluted</b>	<b>\$1.78</b>	<b>\$1.97</b>	<b>\$2.42</b>	<b>\$2.64</b>
<b>DPS</b>	<b>\$1.20</b>	<b>\$1.28</b>	<b>\$1.37</b>	<b>\$1.47</b>
<b>CFO</b>	<b>\$ 130</b>	<b>\$ 139</b>	<b>\$ 158</b>	<b>\$ 167</b>
<b>CFI</b>	<b>(1,018)</b>	<b>(216)</b>	<b>(277)</b>	<b>(257)</b>
Issuance of common stock	0.0	0.0	0.0	0.0
Issuance of debt	502	113	113	113
Dividends	-34	-36	-39	-40
<b>CFF</b>	<b>485</b>	<b>101</b>	<b>99</b>	<b>99</b>
Change in cash and cash equivalents	-403	24	-21	9
Net utility plant	2,206	2,323	2,495	2,644
Cash and cash equivalents	18	42	21	30
Other current assets	109	112	115	117
Total current assets	127	154	136	148
Regulatory assets	114	114	114	114
Goodwill	628	628	628	628
Other assets	57	57	57	57
<b>Total assets</b>	<b>3,132</b>	<b>3,276</b>	<b>3,430</b>	<b>3,591</b>
Total common stockholders' equity	\$ 890	\$ 974	\$ 990	\$ 1,009
Long-term debt, less current	1,261	1,187	1,195	1,203
<b>Total capitalization</b>	<b>2,151</b>	<b>2,161</b>	<b>2,185</b>	<b>2,212</b>
Total current liabilities	235	349	460	574
Deferred income taxes	196	193	190	188
Pension and postretirement benefits oth	108	108	108	107
Other long-term liabilities	45	45	45	45
Advances for construction	112	135	157	180
Contributions in aid of construction	286	286	286	286
<b>Total capitalization and liabilities</b>	<b>3,132</b>	<b>3,276</b>	<b>3,430</b>	<b>3,591</b>



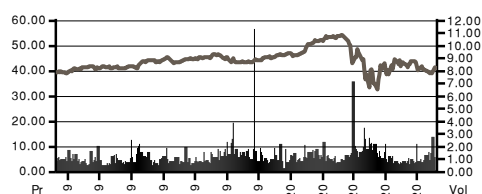
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**Rating:** Neutral  
**Price Target:** N/A

**Price Target Metrics:**  
N/A

**Current Price:** \$39.90  
**Float:** 244.3MM  
**Diluted Shares:** 255.1MM  
**Short Interest:** 5.3MM  
**Average Daily Volume:** 1,130k  
**52 Week Range:** \$30.40 - \$54.52  
**Market Cap:** \$10,177MM  
**Cash and Investments:** \$5MM  
**Debt:** \$4,754MM  
**Enterprise Value:** \$14,925MM

**PRICE & VOLUME CHART**



**ESTIMATES \$ (MMs except multiples & EPS)**

	2019	2020	2021	2022
<b>EPS (Diluted)</b>				
FY	\$1.47A	\$1.55E	\$1.66E	\$1.76E
P/E	27.1x	25.7x	24.1x	22.7x
<b>Dividends Per Share</b>				
FY	\$0.907A	\$0.970E	\$1.038E	\$1.111E
Dividend Yield	2.3%	2.4%	2.6%	2.8%

## Essential Utilities, Inc.

(NYSE: WTRG)

### Gas deal muddled the water

#### Summary:

We are initiating coverage of WTRG with a Neutral rating as we see the stock as close to fairly valued given its water/gas utility mix. WTRG's ~6.3%/7% EPS/DPS CAGR between 2019-2022 should be driven by a 6-7% water and 8-10% rate base growth as well as merger-related synergies related to Peoples Gas. To us, the recent addition of the gas utility to WTRG's core water utility business has diminished the scarcity value of the pure-play water utility in exchange for just a ~150 bps pick-up up in WTRG's consolidated EPS growth. WTRG should try to get some incremental gas utility earnings in PA through a catch-up repair tax deduction, though we'd expect the earnings benefit to be largely clawed back by the state. Assuming no federal infrastructure bill, WTRG could see some incremental municipal water/wastewater M&A on the back of the COVID-19 pandemic, but we prefer to play this benefit through AWK.

#### Highlights

**Regulated water (~67% of 2022 EPS):** WTRG's 6-7% water rate base CAGR through 2022 does not incorporate growth through muni acquisitions of water/wastewater systems though WTRG has been very successful at those, especially in PA, its key jurisdiction (68% of 2019 water rate base). All in, we expect WTRG to deliver a ~7% rate base CAGR through 2022, off of 2019 of \$5B. Without a federal infrastructure bill supporting upgrades of municipal water/wastewater system, they are likely to be sold to private operators, such as WTRG, at an accelerated pace, following the COVID-19 outbreak, we believe. The growth in WTRG's water rate base should outpace the growth in its water net income through 2022, however, as the Aqua PA pulled forward its earnings through a repair tax election in 2012.

**Regulated gas (~33% of 2022 EPS):** The 8-10% rate base CAGR on the gas side, together with a recently completed gas rate case in PA and some cost efficiencies related to the merger with WTRG should deliver a 17% net income CAGR for Peoples between 2019 and 2022. That in turn should drive a 6.3% consolidated EPS CAGR for WTRG. That's 100-150 bps higher than our net income growth expectations for WTRG's standalone water business, and admittedly, there could be some further upside to the gas capex and PA could allow WTRG to retain a portion of a catch-up repair tax adjustment. We remain skeptical, however, about the strategic rationale of the gas acquisition as to us it has diminished the scarcity value of WTRG's water utility.

**2020 earnings:** With higher residential water volumes offsetting lower C&I consumption (~20% of total volumes) and regulators likely allowing for deferrals of COVID costs, WTRG doesn't see risks related to its pro forma 2020 EPS guidance of \$1.53-1.58, especially with additional cost levers on the back of the Peoples merger. This should be a quiet year on the regulatory front except for a pending small rate case in NC and a likely filing for a catch-up repair tax deduction in PA, though the timing of the latter is uncertain given the pandemic.

#### WTRG: EPS breakdown by segment (\$)

WTRG	2018A	2019A	2020E	2021E	2022E	'19-'22 CAGR
Regulated water utilities	1.41	1.47	1.09	1.16	1.22	
Regulated gas utilities	0.00	0.00	0.57	0.67	0.70	
Parent	0.00	0.00	-0.10	-0.17	-0.16	
<b>Total EPS</b>	<b>1.41</b>	<b>1.47</b>	<b>1.55</b>	<b>1.66</b>	<b>1.76</b>	<b>6.3%</b>
<b>DPS</b>	<b>0.85</b>	<b>0.91</b>	<b>0.97</b>	<b>1.04</b>	<b>1.11</b>	<b>7.0%</b>
Dividend payout	60%	62%	62%	63%	63%	

Source: Company data for 2018-2019; Seaport Global Securities

#### Company Description:

WTRG owns and operates water utilities (1 million accounts) and gas utilities (0.74 million accounts) in 10 states though mainly PA.



## Risks

**Allowed ROEs for WTRG's regulated utilities could fall due to lower market interest rates:** Equity returns/ROE of regulated electric/gas/water utilities are indirectly linked to the 10-year Treasury yield. The average allowed ROE of a regulated utility in the US dropped just 25 bps since 2008 despite a 152 bps drop in the average 10-year T yield over this period. However, state utility regulators could sharply reduce allowed ROEs of regulated utilities going forward which currently average 9.75% average. The allowed ROE together with an equity ratio are the key drivers of regulated utility earnings. WTRG's only pending rate case (in NC) is very small.

**Lower sales volumes could weigh on WTRG's realized ROEs and thus earnings:** A utility can see a meaningful deficiency between its realized and allowed ROE depending on the level of sales volumes and operating expenses. While the latter can be controlled, sharp reductions in sales volumes due to energy efficiency (residential and commercial sales) or closure of industrial facilities. The latter is particularly pronounced during the COVID pandemic. The sharply lower C&I sales volumes could weigh on utility earnings beyond 2020. While rate cases could true up sales volume assumptions, utilities could delay rate filings because their ROE could be reduced during those proceedings on the back of sharply lower interest rates.

**Rate case outcomes are hard to predict:** While regulated utilities are allowed to recover prudently incurred costs, it's up to state utility regulators to determine which costs are in fact recoverable and the return on regulated assets. Some rate case requesting higher revenues may end with a reduction in authorized rates thus revenues and thus earnings. WTRG's regulatory calendar is quiet in 2020, with a pending small rate case in NC, and a likely filing for a catch-up repair tax adjustment for Peoples in PA.

**Gas utilities have a higher operating risk than water utilities:** Overpressurized gas systems seem to happen more frequently among gas utilities in the US. While we recognize that Peoples Gas is a well-managed system, WTRG's risk profile could further deteriorate with any gas-related operational issues.

WTRG	2018A	2019A	2020E	2021E	2022E
Operational EBITDA	470	505	868	920	984
Operational EBIT	323	349	604	641	690
Net interest expense	99	100	201	209	227
Ordinary Profit Before Tax	252	269	431	459	490
Income tax	1	7	34	37	39
Net profit	251	262	396	422	451
S/O (m)	178	178	255	255	256
<b>Diluted EPS</b>	<b>1.41</b>	<b>1.47</b>	<b>1.55</b>	<b>1.66</b>	<b>1.76</b>
<b>DPS</b>	<b>0.85</b>	<b>0.91</b>	<b>0.97</b>	<b>1.04</b>	<b>1.11</b>
Cash	4	1,869	5	5	5
Receivables	101	108	109	113	118
Inventory	16	18	30	30	30
Other short-term assets	26	18	18	18	18
Other-long term assets	887	1,003	3,810	3,810	3,810
Property, plant, and equipment	5,930	6,346	8,962	9,113	9,249
<b>Total assets</b>	<b>6,965</b>	<b>9,362</b>	<b>12,934</b>	<b>13,089</b>	<b>13,230</b>
Financial liabilities	117	117	496	496	496
Operating liabilities	63	67	109	109	109
Other liabilities	108	108	220	220	220
Deferred credits	2,068	2,057	2,758	2,757	2,757
Long-term debt	2,398	2,943	4,750	5,063	5,384
Shareholders' equity	2,210	4,070	4,601	4,444	4,264
<b>Total liabilities and equity</b>	<b>6,965</b>	<b>9,362</b>	<b>12,934</b>	<b>13,089</b>	<b>13,230</b>
Net income	251	262	396	422	451
D&A, goodwill amortisation	147	156	264	279	294
Other non cash elements	-54	-40	-6	-6	-6
Funds from operations	344	379	654	695	738
Non-cash working capital	25	-40	43	0	-1
<b>CFO</b>	<b>369</b>	<b>339</b>	<b>697</b>	<b>694</b>	<b>738</b>
Net investments in fixed assets	-641	-610	-6,555	-765	-780
Net investments in financial assets	2	6	0	0	0
<b>Free cash flow before dividends</b>	<b>-271</b>	<b>-266</b>	<b>-5,858</b>	<b>-71</b>	<b>-42</b>
Dividends paid	-151	-161	-229	-245	-284
Free cash flow after dividends	-422	-427	-6,087	-316	-327
Changes in capital	2	1,935	2	2	3
Changes in financial debt	421	386	4,220	313	323
Adjustment for minorities / miscellaneous	-2	-28	1	1	1
Increase in cash	-1	1,866	-1,864	0	0

## Utilities/Power Disclosures

I, Angie Storozynski, hereby certify: (1) that all of the views expressed in this report accurately reflect my personal views about any and all of the subject securities or issuers; and (2) that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

As with all employees of Seaport Global Securities LLC, a portion of our analysts' compensation is paid from the total collection of revenues from all areas of the firm including but not limited to Investment Banking and Sales and Trading departments. In no instance are research analysts' compensation directly derived from Investment Banking revenues.

### Risks & Considerations for American Water Works Company, Inc. American Water Works Company, Inc. (AWK)

**Allowed ROEs for AWK's regulated utilities could fall due to lower market interest rates:** Equity returns/ROE of regulated electric/gas/water utilities are indirectly linked to the 10-year Treasury yield. The average allowed ROE of a regulated utility in the US dropped just 25 bps since 2008 despite a 152 bps drop in the average 10-year T yield over this period. However, state utility regulators could sharply reduce allowed ROEs of regulated utilities going forward which currently average 9.75% average. The allowed ROE together with an equity ratio are the key drivers of regulated utility earnings.

**Lower sales volumes could weigh on AWK's realized ROEs and thus earnings:** A utility can see a meaningful deficiency between its realized and allowed ROE depending on the level of sales volumes and operating expenses. While the latter can be controlled, sharp reductions in sales volumes due to energy efficiency (residential and commercial sales) or closure of industrial facilities. The latter is particularly pronounced during the COVID pandemic. The sharply lower C&I sales volumes could weigh on utility earnings beyond 2020. While rate cases could true up sales volume assumptions, utilities could delay rate filings because their ROE could be reduced during those proceedings on the back of sharply lower interest rates.

**Rate case outcomes are hard to predict:** While regulated utilities are allowed to recover prudently incurred costs, it's up to state utility regulators to determine which costs are in fact recoverable and the return on regulated assets. Some rate case requesting higher revenues may end with a reduction in authorized rates thus revenues and thus earnings. AWK has a particularly busy regulatory calendar in 2020, with rate cases in three of its largest jurisdictions – NJ, PA and MO.

**Potentially higher equity needs due to weakening operating cash flows and underfunded pension funds:** Lower customer collections (due to lower sales or non-payment) coupled with growing federal cash taxes and underperforming pension funds should be weighing on operating cash flows of regulated utilities especially during/after the COVID-19 pandemic. That in turn could require some deleveraging of balance sheets of regulated utilities thus more equity. AWK already announced ~\$500m in new equity as soon as 2022, but the issuances could be enlarged and accelerated to protect AWK's credit ratings.

### Other Companies Mentioned in This Report

- American Water Works Company, Inc. (AWK: \$120.17, Buy)
- American States Water Company (AWR: \$75.62)
- California Water Services Group (CWT: \$43.58)
- SJW Group (SJW: \$55.44)
- Essential Utilities, Inc. (WTRG: \$39.90)

Please contact Seaport Global Securities LLC, for important disclosure information for covered companies. Contact the Director of Equity Research at (949) 274-8052 or write to Seaport Global Securities LLC, 600 Anton Boulevard, Suite 1700, Costa Mesa, CA 92626.

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**Neutral** - The investment outlook and risk/reward over the following 12 months are neutral on an absolute basis and relative to the peer group.

**Sell** - The investment outlook and risk/reward over the following 12 months are unfavorable on an absolute basis and relative to the peer group.

**NA** - A rating is not assigned.

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**Sell** - The investment outlook and risk/reward over the following 12 months are very unfavorable on an absolute basis and relative to the peer group.

**NA** - A rating is not assigned.

### Ratings Distribution

Rating	Research Coverage		Investment Banking Clients*		
	Count	% of Total	Count	% of Total	% of Rating Category
<b>Buy</b>	49	55.1%	3	75.0%	6.1%
<b>Neutral</b>	36	40.4%	0	0.0%	0.0%
<b>Sell</b>	4	4.5%	1	25.0%	25.0%
<b>Total</b>	89	100.0%	4	100.0%	4.5%

\*Investment banking clients are companies for whom Seaport Global Securities has provided investment banking services in the previous 12 months.

*Note: Ratings Distribution as of March 31, 2020*

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